

as the employer of such individual under section 401(c)(4).

(b) *Distributions including securities of the employer corporation*—(1) *In general.*

(i) If a trust described in section 401(a) makes a distribution to a distributee, and such distribution includes securities of the employer corporation, the amount of any net unrealized appreciation in such securities shall be excluded from the distributee's income in the year of such distribution to the following extent:

(A) If the distribution constitutes a total distribution to which the regulations of paragraph (a)(6) of this section are applicable, the amount to be excluded is the entire net unrealized appreciation attributable to that part of the total distribution which consists of securities of the employer corporation; and

(B) If the distribution is other than a total distribution to which paragraph (a)(6) of this section is applicable, the amount to be excluded is that portion of the net unrealized appreciation in the securities of the employer corporation which is attributable to the amount considered to be contributed by the employee to the purchase of such securities.

The amount of net unrealized appreciation which is excludable under the regulations of (A) and (B) of this subdivision shall not be included in the basis of the securities in the hands of the distributee at the time of distribution for purposes of determining gain or loss on their subsequent disposition. In the case of a total distribution the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution shall be considered as a gain from the sale or exchange of a capital asset held for more than six months to the extent that such appreciation is realized in a subsequent taxable transaction. However, if the net gain realized by the distributee in a subsequent taxable transaction exceeds the amount of the net unrealized appreciation at the time of distribution, such excess shall constitute a long-term or short-term capital gain depending upon the holding period of

the securities in the hands of the distributee.

(ii) For purposes of section 402(a) and of this section, the term "securities" means only shares of stock and bonds or debentures issued by a corporation with interest coupons or in registered form, and the term "securities of the employer corporation" includes securities of a parent or subsidiary corporation (as defined in subsections (e) and (f) of section 425) of the employer corporation.

(2) *Determination of net unrealized appreciation.* (i) The amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Thus, if a distribution consists in part of securities which have appreciated in value and in part of securities which have depreciated in value, the net unrealized appreciation shall be considered to consist of the net increase in value of all of the securities included in the distribution. For this purpose, two or more distributions made by a trust to a distributee in a single taxable year of the distributee shall be treated as a single distribution.

(ii) For the purpose of determining the net unrealized appreciation on a distributed security of the employer corporation, the cost or other basis of such security to the trust shall be computed in accordance with whichever of the following rules is applicable:

(A) If a security was earmarked for the account of a particular employee at the time it was purchased by or contributed to the trust so that the cost or other basis of such security to the trust is reflected in the account of such employee, such cost or other basis shall be used.

(B) If as of the close of each taxable year of the trust (or other specified period of time not in excess of 12 consecutive calendar months) the trust allocates among the accounts of participating employees all securities acquired by the trust during the period (exclusive of securities unallocated under a plan providing for allocation in whole shares only), the cost or other

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basis to the trust of any securities allocated as of the close of a particular allocation period shall be the average cost or other basis to the trust of all securities of the same type which were purchased or otherwise acquired by the trust during such allocation period. For purposes of determining the average cost to the trust of securities included in a subsequent allocation, the actual cost to the trust of the securities unallocated as of the close of a prior allocation period shall be deemed to be the average cost or other basis to the trust of securities of the same type allocated as of the close of such prior allocation period.

(C) In a case where neither (a) nor (b) of this subdivision is applicable, if the trust fund, or a specified portion thereof, is invested exclusively in one particular type of security of the employer corporation, and if during the period the distributee participated in the plan none of such securities has been sold except for the purpose of paying benefits under the trust or for the purpose of enabling the trustee to obtain funds with which to exercise rights which have accrued to the trust, the cost or other basis to the trust of all securities distributed to such distributee shall be the total amount credited to the account of such distributee (or such portion thereof as was available for investment in such securities) reduced by the amount available for investment but uninvested on the date of distribution. If at the time of distribution to a particular distributee a portion of the amount credited to his account is forfeited, appropriate adjustment shall be made with respect thereto in determining the cost or other basis to the trust of the securities distributed.

(D)(1) In all other cases, there shall be used the average cost (or other basis) to the trust of all securities of the employer corporation of the type distributed to the distributee which the trust has on hand at the time of the distribution, or which the trust had on hand on a specified inventory date which date does not precede the date of distribution by more than twelve calendar months. If a distribution includes securities of the employer corporation of more than one type, the average cost (or other basis) to the trust

of each type of security distributed shall be determined. The average cost to the trust of securities of the employer corporation on hand on a specified inventory date (or on hand at the time of distribution) shall be computed on the basis of their actual cost, considering the securities most recently purchased to be those on hand, or by means of a moving average calculated by subtracting from the total cost of securities on hand immediately preceding a particular sale or distribution an amount computed by multiplying the number of securities sold or distributed by the average cost of all securities on hand preceding such sale or distribution.

(2) These methods of computing average cost may be illustrated by the following examples:

*Example 1.* A, a distributee who makes his income tax returns on the basis of a calendar year, receives on August 1, 1954, in a total distribution, to which paragraph (a)(6) of this section is applicable, ten shares of class D stock of the employer corporation. On July 1, 1954 (the specified inventory date of the trust), the trust had on hand 80 shares of class D stock. The average cost of the 10 shares distributed, on the basis of the actual cost method, is \$100 computed as follows:

Shares	Purchase date	Cost per share	Total cost
20 .....	June 24, 1954 .....	\$101	\$2,020
40 .....	Jan. 10, 1953 .....	102	4,080
20 .....	Oct. 20, 1952 .....	95	1,900
80 .....	.....	8,000	

*Example 2.* B, a distributee who makes his income tax returns on the basis of a calendar year, receives on October 31, 1954, in a total distribution, to which paragraph (a)(6) of this section is applicable, 20 shares of class E stock of the employer corporation. The specified inventory date of the trust is the last day of each calendar year. The trust had on hand on December 31, 1952, 1,000 shares of class E stock of the employer corporation. During the calendar year 1953 the trust distributed to four distributees a total of 100 shares of such stock and acquired, through a number of purchases, a total of 120 shares. The average cost of the 20 shares distributed to B, on the basis of the moving average method, is \$52 computed as follows:

	Shares	Total cost	Average cost
On hand Dec. 31, 1952 .....	1,000	\$50,000	\$50